Foreign Direct Investments: Financing Sustainability
19-20 June, 2002 – Belgrade
Federal Republic of Yugoslavia

Workshop Organizer:

Ministry for the Protection
Of Natural Resources and the Environment
Republic of Serbia
And
United Nations Environment Programme

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INTRODUCTION

As the post-conflict recovery process gains ever-increasing momentum in the Federal Republic of Yugoslavia (FRY), environmental protection must evolve alongside economic and social development. The post-conflict transitional environment represents an opportunity for FRY and its republics to reform its environmental institutions, stop the degradation of its precious environment and, at the same time, create a sound economy that is based on the principles of sustainable development. The "Triple Bottom Line" philosophy of sustainable development – namely economic, environmental and social considerations – are a sound guiding principle for balanced growth.

While political backing of environmental and associated social issues is gaining wide support, sustainability considerations and needs are not guiding the policies or the investments of the recovery period. This development is setting a risk that the economic growth will further increase the environmental burden of industry and therefore jeopardize the benefits from economic modernisation and recovery.

Building environmental and sustainability considerations into all aspects of Foreign Direct Investment (FDI) decision making both from the perspective of the investor and the recipient country is a key challenge. Sustainability, if it is to be integrated into any FDI process, needs to be considered from the investment concept stage as it becomes much more costly to factor it in afterwards. Also, the use of sustainability as an advanced socio-economic and environmental risk management approach can be a powerful tool to ensure the integrity and long-term viability of an FDI process. Increasingly, FDI will be governed by the disciplines of accountability, transparency, disclosure and equity. Countries that create a framework supporting these emerging disciplines of international investment and finance will be in position to attract long term capital supporting the goals of sustainable development.

Key questions to address within the FRY context in the near future include:

- What practical steps can both or multiple parties in an FDI process take to ensure their sustainability concerns and opportunities are addressed?
- How can international partners, including UNEP, facilitate this process?
- What is the responsibility of the finance sector in this?

On June 19 2002, the Ministry for Protection of Natural Resources and Environment of Serbia, organized in cooperation with UNEP (UNEP Post Conflict Assessment Unit PCAU and UNEP Finance Initiatives, FI) a roundtable meeting in Belgrade exploring Foreign Direct Investment (FDI) and Sustainability. Within the context of economics and finance, the sustainability component of the event focused on how FRY can attract the "right kind of investment" that supports the country's long-term economic, environmental and social fabric.

The aim of the workshop was to introduce key stakeholders in Serbia and Montenegro – national and international governmental, financiers, industrialists and business people – to the opportunities and challenges associated with Foreign Direct Investment (FDI). The workshop highlighted public-private partnership approaches and innovative financing mechanisms supporting FDI in FRY.

An understanding was also developed of how to boost capacity within public and private constituencies within FRY to attract the "right kind" of FDI - dynamic, productive investments that respect high environmental and sustainability standards. Further, the event allowed an opportunity to discuss how sound FDI can be attracted to a country coming out of recent conflict.

On June 20, there were follow up site visits to industrial centres near Belgrade (For full workshop programme, see Appendix 1).

The event delivered:

1. A strong set of recommendations detailing the framework conditions, including regulatory and fiscal incentives that will attract FDI;
2. Identified the need for the implementation of a training course for financial institutions in FRY, with the possibility to make use of the training programme developed by UNEP FI ;
3. Conference proceedings drawing out firm lessons learned from FDI, notably in the steel and urban infrastructure sectors, and
4. A vibrant network of government and business people who have a deeper understanding of the specific challenges for FRY with respect to attracting the "right kind" of FDI.

BACKGROUND

2.1 Growth of Foreign Direct Investment

The last decades have seen the emergence of global markets, an explosive growth in private sector foreign direct investment (FDI), a significant rise in international portfolio flows, and widespread moves to privatize activities once deemed the sole province of the public sector. In 1992, FDI flows to developing countries were at the US$36 billion mark. Before the decade closed, they had jumped to over US$160 billion, roughly double the flow of Official Development Assistance (ODA). However, a fierce international debate rages around the full environmental, economic and social costs of FDI and what mechanisms are required – both in the recipient country and internationally – to ensure FDI flows build long-term economic vitality, support the social fabric of communities and respect a country's environmental integrity.

The growth in international capital flows is an indicator of the private sector's exploration of new global market opportunities, investor interest in the emerging and transition economies, and of the new pro-activity of countries seeking to attract international capital. However, the flow of private sector resources to the developing countries and economies in transition has been very uneven and in the case of portfolio investments highly volatile. The vast majority of FDI, some 75 percent, has gone to just ten middle-income countries. Furthermore, FDI is heavily concentrated in a few sectors: automotive, chemicals, electronics, energy, petroleum and petrochemicals, and pharmaceuticals. Lesser developed countries lost out heavily: in 1998, the 48 least developed countries attracted less than US$3 billion and African countries together received only about one percent of global flows.

2.2 Drivers of Foreign Direct Investment

FDI is driven by both short to mid-term commercial interests and the long-term strategic considerations of corporations and countries. Increasingly, markets in key sectors in the industrialized world are saturated, highly competitive, and offer low and diminishing profit margins and limited prospects of long-term growth as the populations of OECD countries age. Many large companies with global reach see transition economies and the developing world as their key future markets, capable of offering growth and new business prospects. At the same time, many private sector firms are increasingly coming to recognize the business importance – in terms of reputation, license to operate, and broader risk management concerns - of socially and environmentally acceptable activities.

When international companies or consortia consider FDI options, political risks, reputational issues connected to governance questions, and a wide range of operational challenges, above and beyond the normal question of commercial opportunities, create significant constraints in many countries.
Issues likely to undermine a country's attractiveness to FDI include: lack of a skilled and

trained labour pool; endemic corruption issues; the potential of social and civil disruption; and limited natural resource stocks.
In private sector investment decisions, political risk is often the primary risk when assessing transition and developing world opportunities. In urban infrastructure projects, for example, local authorities most often do not have an international credit rating or a track record upon which the private sector can base a judgment of credit worthiness. Changing political leadership at the local authority level, and at the national level, can create risks of breach of contract, currency inconvertibility, and expropriation. In the worst case for a commercial entity, conflict, war or civil unrest can put the assets and the private sector's ability to operate at risk.

2.3 New Public-Private Mechanisms to Finance the "Right Kind" of FDI

The development of new types of public-private partnerships (PPPs) to promote FDI are beginning to emerge. The development and implementation of such innovative PPPs create a number of operational challenges for recipient countries, aid agencies and the private sector partners. Broad operational challenges include: balancing private sector interests with those of aid agencies when awarding Official Development Assistance (ODA) linked to FDI; ensuring rigorous competitive assessment and full transparency in bidding processes while avoiding bureaucratic delays; and dealing with programmatic conflicts of interest between individual companies and aid agencies. Both the public and the private sector need an enhanced understanding of how the other operates and of their accompanying expectations and disciplines for effective partnerships to be developed.

Broadening private flows to a wider range of transition economies and developing countries is necessary to address key sustainable development challenges. The thinking, approaches, and tools needed to increase private sector capital flows to support the sustainability agenda in developing and transition countries are slowly emerging.

Market supporting framework conditions will remain the primary consideration for a country's ability to attract international capital. Political risk issues are paramount when the private sector considers investing in a country or region. Innovative fusions of ODA and FDI based on new forms of public-private partnerships could act to reduce real and perceived political risk considerations. Partnerships built on enhanced understanding of public-private expectations and disciplines could act as a catalyst to attract new and additional private capital sources to a wider spread of countries. ODA which supports and complements market- oriented solutions and fosters capacity building to enhance a country's ability to benefit from market dynamism, will play a pivotal role in boosting the ability of more countries to attract capital.

OPENING SESSION

3.1 Mr. Mikko Halonen
United Nations Environment Programme

The finance sector is crucial partner in the rebuilding of FRY. However, financial and industrial activity must respect the principles of sustainable development. "Foreign Direct Investments: Financing Sustainability" has been conceived by FRY authorities in cooperation with UNEP to provide guidance to national authorities, financial institutions, and UNEP, as to how to turn these principles into reality.

This event will further extend the fruitful co-operation between FRY and UNEP to strengthen the environmental awareness and build institutional capacity for environmental management in FRY. Moreover, this event is part of the UNEP Programme "Clean-up of Environmental Hotspots in FRY". UNEP hopes that the various representatives from the environmental hotspots and elsewhere, will be able to gain knowledge from this event and create a process which will enable them to raise the required investments for sustainable development.

3.2 Mr. Ivan Rasulic
Federal Ministry of International Economic Relations

The Federal Ministry of International Economic Relations has as one of its key aims to harmonize financial aid and financial mechanisms in support of sustainable development.

These activities are concentrated at both the local and global level, and consist of comprehensive aid, not only in material terms, but also in terms of raising awareness of the challenges facing the Federal Republic of Yugoslavia (FRY).

It is clear that environmental issues do not recognize national borders, and we consider UNEP to be the most competent authority for undertaking international activities on the environment. This meeting provides the opportunity to exchange experiences, and also to introduce UNEP to some of the unique problems which we face.

The Federal Republic of Yugoslavia has a number of specific environmental problems. It is "paying the price" for industrialization and development. This is due, in part, to the various obstacles to development – including sanctions and civil wars, most recently – and this has affected the level of environmental protection applied to development. In some regions, development – and the legislation for environmental protections, are "starting from scratch".

Further, FRY is heavily involved in the clean up and remediation of environmental damage which was caused to industrial sites, including oil refineries and chemical facilities. There

also remain long term problems, such as depleted uranium and air pollution.
In determining its course for the future, FRY admits that it faces significant challenges, and has appealed to experts to highlight problems to relevant authorities. Such expertise and experience is critical, as FRY cannot clean up on its own.

However, FRY has indicated that though it accepts foreign aid, it does so only as a last resort, and in cases where such aid is accepted, it must be part of a mutually beneficial program.

FRY is clearly in a period of transition, where it is establishing new systems of values and practices, with the ultimate goal remaining full membership within the European Union. A critical process along this path is the harmonization of environmental and sustainable development principles into policy making and decision making processes.

With the financial situation of the country gaining stability, as a result of both the write-off of accrued debts, and the servicing of remaining debts, FRY is open to new projects. This is further evidenced in the development of concession law, which will provide clear guidelines for domestic and foreign partners.

3.3 Ms. Andjelka Mihajlov
Ministry for Protection of Natural Resources and the Environment of Serbia

This meeting is an important gathering in terms of advancing the necessary policy reforms in FRY.

When we consider the four components of sustainable development – political, economic, social, and environmental, we are reminded that we cannot develop only one area. Instead, we must develop policies which embrace all of these elements.

In trying to achieve this, it has been important for FRY to build bridges with UNEP, international institutions, and small and medium sized enterprises. As evidence of this sort of collaboration, we are currently involved with the World Bank on over 200 projects.

This cooperation is critical, and failure to cooperate only makes the roads to the achievement of our goals longer.

3.4 Mr. Paul Clements-Hunt
United Nations Environment Programme – Finance Initiatives

A significant challenge for economies in transition is not only in attracting foreign direct investment, but in attracting the *right kind* of foreign direct investment (FDI).

FDI is long term capital which is used to build commercial, industrial and social infrastructure. Frequently, these developments – and the capital which fuel them – are private, but increasing public-private partnerships are found.

When we compare foreign direct investment and overseas development aid, we see that FDI is increasing, while ODA is decreasing. With this, we see the emerging importance of private capital in the global economy. However, the distribution of FDI is not equal. Rather, 80% of foreign direct investment goes to only 20 countries.

Not only are we seeing a geographical imbalance though, we are also seeing a sectoral imbalance, with foreign capital in a limited number of countries, *and* in a limited number of sectors.

The vast majority of foreign direct investment to date has not integrated social and environmental considerations. However, responsible foreign direct investment can lead to dynamic, productive investments in sound industries. Good FDI is good for communities – until now, it has often brought environmental problems, and social dislocation.

There is no doubt that foreign direct investment is a complex process, involving governments, export credit agencies, capital markets, bond markets. However, it has very simple requirements. To attract foreign direct investment, a country must provide:

- a sound legal framework
- a level playing field
- unrestricted capital movement

In return for such a business environment, communities must ask for investment which respects sustainability.

There are a number of "push and pull" factors which make this a good idea for companies as well.

On the "push" side, reputational issues are important for any company, and must be considered, particularly in light of the increased recognition and importance of consumer conscience. On the "pull" side, progressive corporations are increasingly seeing sustainability as giving them a competitive edge. Moreover, it is a powerful risk management tool, and can bring down the cost of capital for companies who embrace these principles.

The Competition for Capital and the "Right Kind" of FDI:

Paul Clements-Hunt of UNEP Finance Initiatives said future Foreign Direct Investment (FDI) across the global economy would be governed by the disciplines of accountability, transparency and disclosure with respect to social and environmental impacts of projects.

"In our wired CNN age, increasingly, there will be fewer places for bad projects to be hidden. Investors and companies connected to FDI projects which have detrimental sustainability impacts will be exposed by the media and civil society groups. This will create reputational risks and a raised cost of capital where the whole spectrum of risks are not assessed or managed effectively, " he explained.

Post the conflict, he said, F.R.Y. was entering a new phase when the energy, creativity and vision of its entrepreneurs would be pitched into a "competition for capital." Just as F.R.Y. would be competing for capital to fund its industrial, infrastructure and utility needs, so F.R.Y. should strive to attract the "right kind of FDI." By the "right kind of FDI", Clements-Hunt added, he meant stable, long-term capital which deepens both the economic and social fabric of the communities to which it is directed as well as safe-guarding and, ideally, enhancing the environmental capital of the area.

To attract such FDI, communities and authorities in F.R.Y. will have to fully understand the dynamics of the risk-reward equation that governs FDI projects. In future, we will see a greater appreciation of the environmental and social aspects of this risk equation. More specifically, FDI projects which do not – at the outset – fully assess sustainability risks and set in place rigorous risk management approaches will not provide communities with the most effective type of investment for balanced long-term growth.

"Communities and authorities have the right to be more demanding of FDI projects to ensure their long-term economic, social and environmental health. The "right kind of FDI" will be for the long haul and, quite simply, a rigorous sustainability approach is an effective way of assessing a broader range of risks and ensuring opportunities are maximised if a sustainable development ethos is built into the project from the outset."

FDI is a long term, capital intensive investment, which must be integrated into the communities in which they are based – both the economic and the social elements must be considered.

Indeed, with the finance sector under the spotlight, we are witnessing the emergence of a new FDI dynamic – one in which issues of governance, accountability, and transparency are also increasingly critical, presenting an "ideal market" for clean investments.

Free moving capital is a good thing *if* markets are working properly, *if* communities are not exploited, and we can ensure that social and environmental considerations are integrated into investment decisions

PLENARY SESSION

4.1 Ms. Milica Zatezalo
Ministry of International Economic Relations, Republic of Serbia

Continuing development of the concession law provides some of the critical legal framework in which FDI is made. A concession is the right to use natural resources in a country, and such permission can be given to a local or foreign entity. Concessions can be an efficient way of managing rights to public goods.

FRY is currently characterized by a lack of capital, particularly with respect to large investment projects, such as water and waste infrastructure, or transportation networks.

For concessions to be granted in the most transparent and equitable way, clear concession laws can protect the interests of both the state and investors.

This law contains a number of new features, including a new process of granting concessions. For all concessions, there will be a public tender process, under a procedure which is regulated by law. This law, waiting to be presented to the Parliament, covers water, sanitation, storage, transportation, the distribution of petroleum, and tourist infrastructure.

Environmental protection is an important aspect of this law, and environmental impact assessments a key component of assessment processes. In cases of environmental harm, there remains the potential for the revoking of a concession.

4.2 Ms. Gordana Danilovic
The Agency for Small and Medium Sized Enterprises

Reviewing the highlights of the SME sector and indicators of the current situation, we see the increasing legal and financial capacity at the government level, to support SME development within FRY.

The basic direction of this new initiative is to create an attractive environment for development, and for the development of SMEs. In many ways, this is a break from past practices, when SMEs were generally more “tolerated” than “supported”.

However, there is increasingly a recognition that in all economies, SMEs are key drivers and engines of development. SMEs provide new employment, produce innovations, encourage competition, and act as subcontractors for large companies.

SMEs are a key factor of dynamic development. In FRY, we have seen significant expansion in this sector since 1993, 1994, to today's total of just below 200,000 SMEs. Of this number, 85% are in the services and trade sectors, while the remaining 15% are in the production sector.

However, there remain 3 key obstacles to SME development:

1. no consistent strategy for SME development

2. no institutional infrastructure to deal with network – legal / administrative obstacles in terms of registration, etc.

3. financial support to SMEs – have not ensured stable financial markets to finance SME projects

An important goal of this initiative to support SMEs is to make it easier for entrepreneurs to receive financial support and access capital. However, other obstacles lie in education and training, production processes, standardization, and environmental protection.

It is also important to provide favourable conditions for SME development. In this, government's role is not in providing equipment, but in creating an encouraging and supporting environment for SMEs and to promote entrepreneurship and innovation.

Financial support remains a key issue for the development of SMEs. With this in mind, FRY is developing a credit guarantee fund, which is meant to act as a driver for SMEs to approach financial institutions, while addressing collateral and security issues. Through the development of government institutional infrastructures for SME support, and the creation of regional networks, government can also cooperate with other sectors (such as private equity funds and venture capitalists), which can aid in implementation.

The government's role is largely to support development of SMEs through advice, and through protecting the interests of SMEs. However, the aid of international institutions, such as EBRD, is also important to the success of these initiatives to build the infrastructure and capacity for a vibrant SME network in FRY.

4.3 Mr. Dejan Rancic
The Agency for Foreign Investments and Export Promotion

FRY is in the process of increasing support to foreign investors, in light of the stimulation that they can provide to local economies. This support comes in a variety of forms, ranging from bringing forward legislation that will stimulate foreign investment, and providing access to Government departments, to assisting in the location of greenfield and brownfield production. In this way, the government can help investors to avoid many of the problems of coming to a new market.

While increasing support to foreign investors, FRY is simultaneously supporting local entrepreneurs through the promotion of their businesses to potential foreign investors, to technical assistance in raising awareness of conditions required for a foreign investor, and emphasizing the potential roles of domestic and foreign partners.

These efforts compliment Serbia's attraction as an investment location, as it is a key transportation hub within Europe, with excellent access to markets in the region, favourable taxation rates, and a considerable amount of underused capacity.

4.4 Mr. Brian Pearce
Forum for the Future

Through the increasing importance of Socially Responsible Investment (SRI) markets, it is clear that capital markets can significantly affect FDI.

A key question confronts us: "Is it possible to attract the FDI which is required *and* protect the environment?"

There are numerous benefits of FDI, but ironically, the spin-offs are largest in the service sector, not in the natural resource sector, where most FDI has been concentrated.

There are a number of misconceptions surrounding how countries can best attract foreign direct investment. These include the reluctance to increase environmental regulation for fear of creating, "regulatory chill", and the idea that the forces of competition will encourage companies to move to "pollution havens" - countries with weak environmental laws.

In fact, there is very little evidence that international companies relocate to countries with low environmental standards. Further, evidence suggests that environmental costs are small – in the range of only 2-3% of total production costs for an operation, and that this cost is only one of a number of factors which a potential investor will consider when assessing an opportunity. Other considerations include available infrastructure, the cost of inputs, productivity, and the potential for growth.

The primary interest for companies is not just lax environmental regulation, but rather consistency in application and enforcement ("a level playing field"), and good governance – an issue which is increasingly important to international capital markets (who are the shareholders in multinationals).

Pollution Havens - A Myth Dispelled:

Brian Pearce, Forum for the Future, explored the capital market pressures which surround FDI. He asked the fundamental question of whether it is possible to "Attract FDI and have Sustainable Development?"

Pearce presented the evidence for and against the "Pollution Haven" theory that suggests companies promulgating FDI target countries with low environmental and social standards. In summary, he indicated that although there is evidence to suggest that "Bad" FDI projects exist and some governments fear that raising regulatory standards will put international inves-

tors off, there is little hard evidence to suggest that companies relocate production to countries with low standards.

In reality, quality investors prioritize the following factors when weighing up different FDI opportunities and production locations: quality of infrastructure; access to inputs; wage costs and labour productivity; political risks; and the size and growth potential of markets.Critically, the backers of the "right kind of FDI" look for consistent rather than low enforcement of environmental and social regulations.

Post the ENRON scandal and the wave of corporate governance issues for big business, the attention of capital markets has been drawn to how companies manage the whole range of tangible and intangible risks. Environmental and social risks are often qualitative in nature and, as such, can be more difficult to assess. However, the emergence of indices such as the Dow Jones Sustainability and the FTSE4Good, are an indication of how in future capital markets will build in a premium for the way in which listed companies, at least, handle the complex issues surrounding sustainable development.

Such developments, explained Pearce, significantly raises the pressures on multi-national companies to assess and manage risks along their entire international supply chain and this has direct implications for the way in which FDI projects are conceived, developed and managed. Those local suppliers, contractors and investors contributing to an FDI process which appreciate the need to raise the "social and environmental hurdle" in the future will be selected by major international investors to work in partnership to implement FDI projects.

A government which creates a sound sustainable development framework and then consistently enforces rules and regulations will be taking a major step in the process to attract the "right Kind of FDI."

Research into how markets value companies with high and low environmental standards suggests that those with high standards have a share price premium.

Capital markets pressures are also being exerted on investment decisions, as we see the rise of SRI investors, and the introduction of "sustainability stock market indices", such as the FTSE4Good and the Dow Jones Sustainability Index.

We are also witnessing the rise of SRI in Europe, with an increasing focus on non-financial risks, reputational risks, corporate governance, and social and environmental performance.

While some of this growth is driven by regulatory pressures, such as disclosure regulations, we also see environmental regulations creating value, as evidenced by the emerging carbon market.

Good corporate social responsibility (CSR) pays. Can you attract FDI and maintain high standards of environmental protection – the answer is yes – as we see that FDI is not attracted by low environmental standards.

4.5 Mr. Anton Lukac
US Steel Kosice

US Steel is a diversified business, which has experience in a variety of joint ventures. US Steel was particularly attracted to the VSZ Steel Plant, as it had modern equipment, a well maintained facility, and a skilled workforce.

Beyond these important factors on the ground, US Steel also considered central Europe to be a good investment decision for a number of reasons:

- potential of economic growth
- healthy and dynamic market economy
- emerging markets
- excellent educational system
- skilled workforce
- cooperative governments
- central Europe's real GDP growth exceeds western Europe's.

Importantly, Serbia is making political and economic progress. The Serbian government is stabilizing the economy, and strengthening democracy. For its part, US Steel's economic development office is contacting companies, and encouraging them to move to the region – this is a key strategy in attracting more customers and maintaining the long term viability of the operations.

4.6 Dr. Joachim Richter
AquaMundo GmbH

Joachim Richter, Managing Director of AquaMundo, provided a background on the structure of a public-private partnership in which AquaMundo is involved.

The business relationship in the Balkans, in particular Montenegro began with AquaMundo being involved in management projects, and has developed into the awarding of concessions to AquaMundo.

Linking infrastructure development to increased investment, foreign direct investment was recognized as an important catalyst to bring tourists into the region, for which a stable water and waste infrastructure was a critical precursor.

According to the lessons learnt by tAquaMundo, it is important to be able to establish guarantees that foreign direct investment money will be used responsibly.

4.7 Mr. John Kirk
Severn Trent Plc

John Kirk outlined the history and regulatory structure of the United Kingdom's water privatization. This is perhaps the most complete model of privatization of water services in so far in Europe.

The water service industry is highly regulated, with regulatory responsibilities divided across three separate regulatory bodies, all reporting to central government. The delivery of water quality standards has meant a huge investment program, with the increased benchmarking and publication of performance.

This strong regulation was recognized as being critical to ensuring the successful delivery of the service. Whatever model is used for privatization – from a totally integrated delivery to public-private joint ventures – water quality, effluent levels, and customer service have the potential to improve. However, some form of strong, politically independent regulation is critical to ensuring the consistent delivery of the capital investment programs and that quality standards are met.

Both the public and private partners can bring important expertise to the partnership. While the private sector can bring improved operations and knowledge, the public sector can bring assistance in terms of a strong regulatory structure or assistance with service delivery.

4.8 Mr. John Etheridge
European Organization for Nuclear Research (CERN)

John Etheridge, Health and Safety Coordinator for European Organization for Nuclear Research (CERN), emphasized the importance of incorporating Environmental Health and Safety considerations into the early stages of any foreign direct investment project.

A comprehensive Environmental Health and Safety plan contributes to both better risk management, and long term productivity increases and cost savings. Such a plan can also reduce the “cost of capital”, due to the level of operational risks which environmental health and safety can mitigate.

4.9 Mr. Henry Russell
European Bank for Reconstruction and Development

The European Bank for Reconstruction and Development (EBRD) can act as an important partner in FRY. With a long-term perspective and mission, and a willingness to share risks – including political risks – the EBRD can assist in access to equity, debt, and trade finance.

This international financial institution, established in 1991, is owned by 62 national and supranational shareholders. It promotes market-based economies in 27 countries in central and eastern Europe and the former Soviet Union, and its activities are spread across a range of sectors, from financial institutions and infrastructure, to automotive, chemicals, steel, and aerospace. EBRD has committed • 20.5 billion for 850 projects to date.

A Focus on the Private Sector:

Henry Russell, Director of the EBRD office in Belgrade, highlighted that cumulative commitments of Euro 2.4 billion had been made since 1994 in the republics of the former Yugoslavia.

As well as effective dispersement of allocated funds, current operational priorities in Yugoslavia include a shift in emphasis to work with the private sector. The range of the private sector focus will include: concessions and attraction of new FDI; restructuring; privatisation; and work with "blue chip" private corporations.

An approach based on sustainable development is integrated across all EBRD operations. EBRD projects, and the financing vehicles that the institution provides and underwrites, adhere to appropriate local, national, European Union and World Bank standards.

Critically, explained Russell, where standards cannot be met initially a compliance plan will be set in place.

These activities and partnerships are supported by an extensive knowledge of local economies and business environments, and dedicated project teams, including nationals of the EBRD's countries of operation. In this way, the EBRD is able to, "combine industry knowledge with experience and contacts in the region to deliver tailored solutions to financing and political risk".

Partnering with the EBRD can act as a catalyst of change, stimulating foreign direct investment. Indeed, attracting third party financing triples EBRD's investments. Domestic capital is also mobilized, and environmentally sound and sustainable projects are promoted.

The key operational priorities of the EBRD in FRY include:

- Implementation and disbursement of 2001 committed funds
- Shift to private sector ("blue chip" private corporates, privatisation, restructuring, concessions and new FDI)
- Demonstrate ways of restructuring large enterprises
- Banking sector and SME support
- Continued infrastructure investment (together with other IFIs co-financing)
- Promote a sound investment climate, good corporate governance and stronger institutions

WORKSHOP FINDINGS AND CONCLUDING REMARKS

The presentations and discussions have identified a number of trends and challenges for FRY in attracting foreign direct investment – and importantly, for foreign direct investment which respects sustainability.

Importantly, all four components of sustainability – political, economic, social and environmental, must be considered to fully embrace the principles of sustainable development.

The Federal Republic of Yugoslavia has specific environmental problems associated with industrialization, the remediation of environmental damage, and has faced numerous obstacles to development. FRY is clearly in a period of transition, where a new systems of values and structures are being established, with a view to full membership in the European Union.

Further, FRY is presently characterized by a lack of capital, particularly with respect to large investment projects – from water and waste infrastructure, to transportation networks, and is keen to attract foreign direct investments and new partnerships to facilitate these projects. At the same time, FRY is working to stimulate the small and medium enterprises within its borders.

Some of the pull factors for FDI
Slide from presentation by Paul Clements Hunt, UNEP Finance Initiatives

5.1 Positive Trends

The positive trends in this process include the adoption of legal and structural elements within FRY, as evidenced through:

- ➢ Strengthening of concession laws incorporating elements of environmental impact assessment and liability for environmental damage.

- ➢ Establishment of an agency for foreign investment and export promotion, focusing on support to foreign investors, in terms of:
  - location of greenfield / brownfield production
  - assistance in avoiding problems associated with coming to a new market
  - bringing forward legislation that will stimulate foreign investment

- ➢ Establishment of an agency for SMEs, working to establish SME development strategy and institutional structures to support SME sector, as well as education and training.

However, there are also wider positive trends, which are beneficial to FRY's efforts to attract FDI, which adheres to the principles of sustainability. In particular, we heard that there is very little evidence that international companies relocate to countries with low environmental standards. The key attractors are often a blend of factors, including good infrastructure, low cost of inputs, high productivity, and the potential for growth. Within the context of consistent and equitable enforcement and good political governance, these factors can create an ideal environment for foreign direct investments.

Also, progressive corporations are increasingly seeing sustainability as a competitive edge and powerful risk management tool, which brings the cost of capital down – those companies, which embrace the principles of sustainability and good corporate governance reap financial and reputational benefits.

5.2 Barriers to Overcome

In order to take full advantage of the opportunities afforded by FRY's period of transition, government, the business community, and wider stakeholders should continue to work towards completing the policy framework, which is being established.

However, some significant challenges remain:

- ➢ Training on developing project proposals and approaching multi-lateral and bilateral donors

- ➢ Continued development of strong, politically independent regulation to ensure consistent delivery of capital investment programs and ensure that quality standards are met

- Balancing environmental costs against other cost considerations, and working to incorporate the principles of sustainability across all activities.

- Working to attract new sources of foreign direct investment; identifying new partnerships; and continuing to "build bridges" between FRY and international institutions, and within FRY itself (for example with the SME sector).

- Ensuring that communities are not exploited – integrating all four elements of sustainability – social, economic, political, and environmental – in implementing foreign direct investment projects.

5.3 Next Steps

The suggestions below are considered as possible "follow on" actions for the Ministry, UNEP and appropriate partners:

1. During 2003, work with selected financial institutions in Belgrade and implement the UNEP Finance Initiatives (FRY) full three-day "Finance and Sustainability" training program for 20-25 invited executives from the FRY financial services community. The course would cover the broad case for sustainability in the finance sector and would then move to present the operational approaches and tools that can be used to implement enhanced environmental and social risk management within a financial institutions involved in FDI processes.
2. Explore options for a follow on conference to be held in the first or second quarter of 2004 and targeting the sustainability needs of institutions specifically involved in the financing of large, urban infrastructure projects. A secondary focus of this meeting would be, also, to bring together international financiers with local project developers – public and private sector - searching for funding.
3. UNEP FI, UNEP PCAU and appropriate partners, will prepare a funding proposal outlining a 36 month capacity building programme to work with financial and capital market institutions in FRY. The purpose of the training based programme would be to boost understanding and capacity within financial and market institutions with respect to capital market and corporate governance, incorporating the disciplines of corporate social responsibility. The proposal would be submitted to appropriate multi-lateral and bi-lateral funding agencies.

Appendix A

Workshop Programme

Wednesday, 19 June 2002

TIME	SESSION
8:00 - 9:00	Registration
9:00 - 9:30	Opening Session ➢ Mr. Ivan Rasulic, Federal Ministry of International Economic Relations ➢ Ms. Andjelka Mihajlov, Ministry for Protection of Natural Resources and the Environment of Serbia ➢ Mr. Paul Clements-Hunt, United Nations Environment Programme - Finance Initiatives Co-Chaired by Mr. Mikko Halonen, United Nations Environment Programme and Mr. Radmilo Pesic
9:30 - 10:00	Plenary Session ➢ Ms. Milica Zatezalo, Ministry of International Economic Relations, Republic of Serbia ➢ Ms. Gordana Danilovic, The Agency for Small and Medium Sized Enterprises ➢ Mr. Dejan Rancic, The Agency for Foreign Investments and Export Promotion Co-Chaired by Mr. Mikko Halonen, United Nations Environment Programme and Mr. Radmilo Pesic
10:00 - 10:30	Coffee Break
10:30 - 12:00	Plenary Session ➢ Mr. Brian Pearce, Forum for the Future ➢ Mr. Anton Lukac, US Steel Kosice ➢ Dr. Joachim Richter, AquaMundo GmbH ➢ Mr. John Kirk, Severn Trent Plc ➢ Mr. John Etheridge, European Organization for Nuclear Research (CERN) Chaired by Mr. Paul Clements-Hunt, UNEP FI

TIME	SESSION
12:00 - 13:45	Lunch Break
12:00 - 12:30	Press Conference
13:45 - 15:30	Interactive Session ➢ Mr. John Kirk, Severn Trent, Plc. ➢ Mr. Joachim Richter, AquaMundo GmbH ➢ Mr. John Etheridge, CERN ➢ Mr. Brian Pearce, Forum for the Future Moderator: Mr. Paul Clements-Hunt, UNEP FI
15:30 - 16:00	Coffee Break
16:00 - 17:00	Plenary Session: The Role of Multilaterals ➢ Mr. Henry Russell, European Bank for Reconstruction and Development ➢ Mr. Paul Clements-Hunt, UNEP FI Co-Chaired by Mr. Mikko Halonen, UNEP, Mr. Paul Clements-Hunt, UNEP FI
17:00 - 18:00	Discussion
18:00 - 18:30	Closing Remarks

Thursday, 20 June 2002

Site visits to industrial facilities:

- Obrenovac-thermoelectric plants TENT-A and TENT-B
- Vreoci-coal drying plant (see picture below)

Appendix B

List of Participants

NAME	COMPANY / ORGANIZATION
Velizar Strumberger	Institute for Geology and Mining
Slobodan Tosovic	Institute for Health Protection, Belgrade
Bozidar Stojiljkovic	"Sintelon" Backa Palanka
Volker Timmermann	German Embassy
Dragutin Grgur	Ministry for Urban Planning and Environment, Montenegro
Mirjana Gucic	Secretariat for Environmental Protection, City of Belgrade
Lazar Krnjeta	"Komdel"
Natalija Bogdanov	Faculty for Agriculture, Zemun
Vesna Rodic	Faculty for Agriculture, Novi Sad
Nevenka Spasojevic	"HIP Azotara", Pancevo
Borislava Kruska	Municipality Pancevo
Dusan Stokic	Chamber of Commerce of Serbia
Mirjana Radulovic	"Zitopromet" A.D. "Spuz"
Ljubo Macic	EPS
Nebojsa Ceran	EPS JP TE "Nikola Tesla"
Dusan Dinjakovic	Municipality Cacak
Milan Kandic	Municipality Cacak
Dragan Marinkovic	Municipality Kragujevac
Mira Zec	NIS Oil Refinery, Pancevo
Rade Borojevic	Chamber of Commerce, Belgrade
Olga Cvetkovic	IHTM
Novcic Dragomir	JP "Srbijasume"
Mirjana Pavlovic	NIS Oil Refinery, Novi Sad
Andrijan Tasic	Town Nis
Rade Sarcevic	Recycling Agency of the Republic of Serbia
Nikola Ille	EBRD
Snjezana Mitrovic	Society "Terras", Subotica
Ljiljana Rajnovic	Agency for Privatisation
Ljubinka Milenkovic	NIS – ENERGOGAS
Gordana Gavrilovic	Municipality Subotica
Katarina Djurovic	NIS JUGOPETROL
Goran Milicev	G17 Plus
Miodrag Popovic	Institute for Water Management "Jaroslav Cerni"
Miletic Miroljub	Car Plant "Zastava" Kragujevac

Katerina Stanic	Institute for Economic Science
Zoran Njegovan	Institute for Economic Science
Nenad Stojimirovic	HIP-PETROHEMIJA
Branislav Gavric	HIP-PETROHEMIJA
Pera Novakovic	"MST" Marketing and Engineering
Dubravka Savic	European Commission of FRY
Wout Soer	European Agency for Reconstruction
Bozidar Gecic	TE "Kolubara"
Aleksandra Milenkovic	Ministry of International Economic Relations, Republic of Serbia
Miodrag Vujosevic	Institute for Architecture and Urban Planning
Ljubomir Jovanovic	Ministry of Trade, Tourism, and Services
Emilija Boti-Raicevic	EPS
Uros Miloradovic	REC
John Kirk	Severn Trent Plc.
Henry Russell	European Bank for Reconstruction and Development
Brian Pearce	Forum for the Future
Joachim Richter	AquaMundo GmbH
Anton Lukac	US Steel Kosice
John Etheridge	CERN
Paul Clements-Hunt	UNEP Finance Initiatives
Trevor Bowden	UNEP Finance Initiatives
David Jensen	UNEP
Mikko Halonen	UNEP
Ivan Rasulic	Federal Ministry of International Economic Relations
Andjelka Mihajlov	Ministry for Protection of Natural Resources and Environment
Radmilo Pesic	Faculty of Agriculture
Dejan Rancic	Agency for Foreign Investments and Export Promotion
Milica Zatezalo	Ministry of International Economic Relations, Republic of Serbia
Gordana Danilovic	Agency for Small and Medium-sized Enterprises
Milovan Studovic	Ministry of Energy and Mining
Verica Curcic	Ministry for Protection of Natural Resources and Environment
Marija Kovacevic	Ministry for Protection of Natural Resources and Environment
Zeljko Pantelic	Ministry for Protection of Natural Resources and Environment
Tereza Brajovic	Ministry for Protection of Natural Resources and Environment
Stevan Starcevic	Ministry for Protection of Natural Resources and Environment
Nikola Pajcin	Ministry for Protection of Natural Resources and Environment
Slavica Konatarevic	Ministry for Protection of Natural Resources and Environment

Further technical information may be obtained from the UNEP Post-Conflict Assessment Unit website at:
http://postconflict.unep.ch

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UNEP

As the post-conflict recovery process gains ever-increasing momentum in the Federal Republic of Yugoslavia (FRY), environmental protection must evolve alongside economic and social development. The post-conflict transitional environment represents an opportunity for FRY and its republics to reform its environmental institutions, stop the degradation of its precious environment and, at the same time, create a sound economy that is based on the principles of sustainable development. The “Triple Bottom Line” philosophy of sustainable development – namely economic, environmental and social considerations – are a sound guiding principle for balanced growth.

Building environmental and sustainability considerations into all aspects of Foreign Direct Investment (FDI) decision making both from the perspective of the investor and the recipient country is a key challenge. Sustainability, if it is to be integrated into any FDI process, needs to be considered from the investment concept stage as it becomes much more costly to factor it in afterwards. Also, the use of sustainability as an advanced socio-economic and environmental risk management approach can be a powerful tool to ensure the integrity and long-term viability of an FDI process. Increasingly, FDI will be governed by the disciplines of accountability, transparency, disclosure and equity. Countries that create a framework supporting these emerging disciplines of international investment and finance will be in position to attract long term capital supporting the goals of sustainable development.

On June 19 2002, the Ministry for Protection of Natural Resources and Environment of Serbia, organized in cooperation with UNEP (UNEP Post Conflict Assessment Unit PCAU and UNEP Finance Initiatives, FI) a roundtable meeting in Belgrade exploring Foreign Direct Investment (FDI) and Sustainability. Within the context of economics and finance, the sustainability component of the event focused on how FRY can attract the “right kind of investment” that supports the country’s long-term economic, environmental and social fabric.

The aim of the workshop was to introduce key stakeholders in Serbia and Montenegro – national and international governmental, financiers, industrialists and business people – to the opportunities and challenges associated with Foreign Direct Investment (FDI). The workshop highlighted public-private partnership approaches and innovative financing mechanisms supporting FDI in FRY.